



UHERO FORECAST PROJECT

KAUAI ECONOMIC OUTLOOK SUMMARY

PREPARED FOR THE COUNTY OF KAUAI

## KAUAI POISED FOR GROWTH, BUT FACING CHALLENGES

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# UHERO

THE ECONOMIC RESEARCH ORGANIZATION  
AT THE UNIVERSITY OF HAWAII

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## **KAUAI ECONOMIC OUTLOOK SUMMARY** PREPARED FOR THE COUNTY OF KAUAI

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## EXECUTIVE SUMMARY

The Kauai economy is poised for additional growth, spurred on by a construction sector that is just now hitting its stride. Visitor industry gains will back off a bit from last year's strong growth, but the level of activity in the sector will remain high. Overall growth in jobs and income will trend lower now that the Island's workforce is nearly fully employed.

- Kauai's visitor industry has had a slow start to the year after a surprisingly strong 2015. We expect moderate additional growth for the key US market and in visitors from international markets other than Japan, which have become more important in recent years. The number of arrivals will grow by roughly 2% annually over the next several years. Late in the decade, growth will slow as capacity constraints become more acute.
- With visitor volumes at an all time high, there has been considerable discussion of the impact of visitors on the Garden Isle's infrastructure. In addition to the perennial traffic headaches, the high number of visitors puts stress on recreational areas. This raises concerns about maintaining a healthy tourism industry and local lifestyle.
- The Kauai labor market has taken a long time to recover from the Great Recession, but unemployment has receded to within one percentage point of its level during the 2005-2007 boom. Job growth will accelerate from 1.4% in 2015 to more than 2% this year. The pace of hiring will slow in 2017 and beyond, easing toward 1% as the construction cycle approaches its peak and the business cycle matures.
- The Kauai construction industry has turned the corner convincingly, and we expect the strong expansion to continue this year. There are a number of resort development and redevelopment projects in the works, as well as several residential and retail projects. The industry remains smaller than during the mid-2000 bubble years, but further growth will bring total employment to 1,800 workers at its peak late in the decade.
- Jobs in the accommodation and food services sector are now well above pre-recession levels, and buoyant construction will lift growth in the trade sector, which has languished recently. Jobs in our broad other services category and in health care will continue to see steady growth. Budgetary constraints at the federal, state, and local levels will limit public sector employment growth.
- There are important developments in other sectors, including the challenges to seed corn and a proposed dairy, ongoing efforts to promote media and technology, and the dramatic transformation that is taking place in Kauai's energy sector.
- Kauai's economy is doing well, but it faces important challenges, including limits to infrastructure, housing affordability, and maintaining a sufficient and sufficiently able workforce. These concerns are mounting at the same time that several County planning initiatives are underway. Finding the right balance among competing objectives will be a significant challenge going forward.

## KAUAI ECONOMIC OUTLOOK

The Kauai economy is poised for additional growth, spurred on by a construction sector that is just now hitting its stride. Visitor industry gains will back off a bit from last year's strong growth, but the level of activity in the sector will remain high. Overall growth in jobs and income will trend lower now that the Island's workforce is nearly fully employed.

## TOURISM

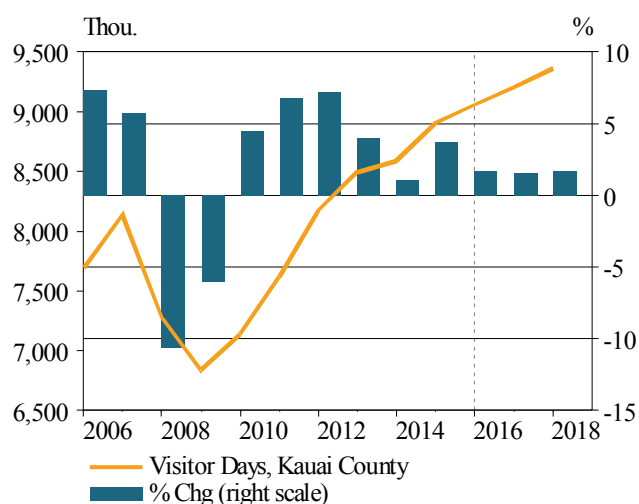
Kauai's visitor industry posted a surprisingly strong year in 2015. Despite evident capacity pressures, resort development will permit further moderate tourism growth over the next several years, supported by healthy economic conditions on the US mainland and the continuing development of international markets other than Japan.

This year has gotten off to a slow start. Total arrivals to the county were unchanged from 2015 levels in the first quarter of this year, although this decline was offset by an increase in length of stay, so that there was a slight increase in visitor days. Scheduled airline seats for direct flights to Kauai are expected to be flat in the second quarter. Hawaiian Airlines is increasing service on direct routes from Oakland and Los Angeles, but these gains will be offset by reduced service by United Airlines out of San Francisco and Denver as well as Canadian air carrier Westjet on its Vancouver route. In recent weeks Island Air has restarted service to Lihue from Honolulu, which will boost interisland lift to the Garden Isle.

While there has been some diversification in recent years toward emerging international markets, the vast majority of visitors to Kauai still come from the US mainland. This has insulated the county's visitor industry to some extent from the effect of recent currency fluctuations. However, the Canadian market took a tumble, with arrivals for the quarter down

12%. With currencies beginning to recover and with sound US labor market conditions, North American markets should be relatively healthy going forward. We expect roughly 2% growth for the US market in each of the next three years. Aggregate visitors from international markets other than Japan will see growth in a similar range.

The Kauai hotel occupancy rate hit a seasonally adjusted 74% in the fourth quarter of last year. While this is the highest rate since 2008, it remains nearly five percentage points below the peak levels reached in the mid-2000s. This picture of relatively mild capacity pressure stands in contrast to what we hear anecdotally, where some industry observers point to much higher usage levels once non-hotel visitor accommodations are considered. Time-share properties, resort condos, and transient vacation rentals make up a substantial share of the market on Kauai, and they generally have higher occupancy rates than hotels (a survey by Hospitality Advisors LLC puts time-share occupancy in the 88-90% range typically). Despite these caveats, the fact that hotel room rates are just now returning to pre-recession levels in inflation-adjusted terms suggests that some slack remains in island-wide visitor accommodations.



WE EXPECT MODERATE FURTHER EXPANSION OF THE KAUAI VISITOR SECTOR.

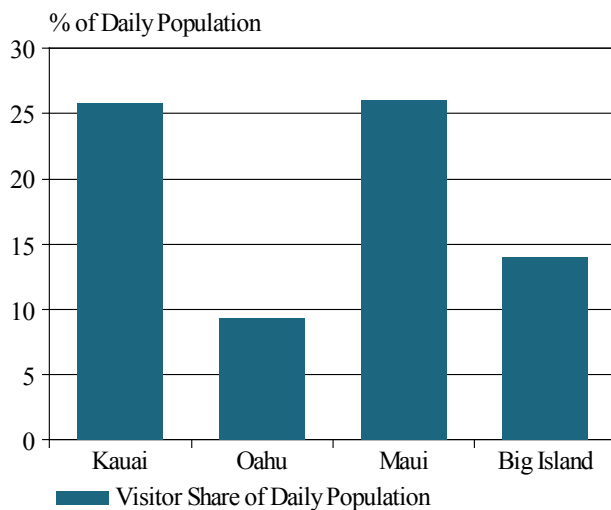
There are a number of new resort developments in the construction pipeline. Late last year, Timbers Resorts began redevelopment of the former Kauai Lagoons site into its new Hokuala resort. The first phase of construction calls for 47 timeshare and fee-simple units split across three low-rise buildings. Future construction could include a small-scale hotel and a mix of timeshare and residential properties; the entire project is slated to include 468 units at full build out. In Wailua, the redevelopment of the Coco Palms resort, shuttered since Hurricane Iniki in 1992, may finally be moving forward. The developer recently obtained funding for the demolition phase and is working to secure full project funding. The County Planning Commission has deferred until early May a decision on whether to grant an extension to an expired demolition permit, pending the outcome of the financing efforts.

Several other resort-related projects are underway or expected to break ground soon. Phase three at Koloa Landing, which will include 200 single-family units, meeting space, and resort amenities, is slated to finish by the end of this year. The Coconut Plantation resort in Waipouli, permitted for 192 multi-family units and a handful of hotel rooms, may begin construction in late fall, and the Hanalei

Plantation resort, with a mix of 120 luxury bungalows and home lots, may also break ground in 2016. The Sheraton Kauai is underway on a conversion of its garden wing into time-shares, and a renovation of the ocean side hotel rooms is slated for later this year.

With visitor volumes at an all time high, there has been considerable discussion of the impact of visitors on the Garden Isle's infrastructure. Last year there were 24,400 visitors on Kauai on a typical day, compared with 71,700 residents, meaning that visitors make up roughly one-quarter of all the people on the island. This visitor-resident mix is similar to levels on Maui but is nearly double the proportion on the Big Island and three times that of Oahu. In addition to the perennial traffic headaches, the high number of visitors puts stress on recreational areas. At Haena State Park / Kee Beach (and the entrance to the Kalalau Trail), proposed plans would impose Hanauma Bay style caps on the number of daily visitors and cars, as well as emphasize the area's cultural and historical significance.

Overall, we expect moderate further expansion of the Kauai visitor sector. The number of arrivals will grow by roughly 2% annually over the next several years. Late in the decade, growth will slow as capacity constraints become more acute. By 2018, the number of annual visitor days, which takes into account length of stay, will be 15% above the 2007 pre-recession peak.



ON A TYPICAL DAY, VISITORS MAKE UP ROUGHLY ONE-QUARTER OF KAUAI'S POPULATION.

## EMPLOYMENT AND INCOME

The Kauai labor market has taken a long time to recover from the Great Recession. Between 2007 and 2009, the county lost nearly 3,000 jobs, and since then payrolls have expanded at only a 1.4% annual average rate. But total nonfarm payrolls are now within 300 of their previous peak. The unemployment rate stood at a seasonally adjusted 3.6% rate in February, just one percentage point higher than

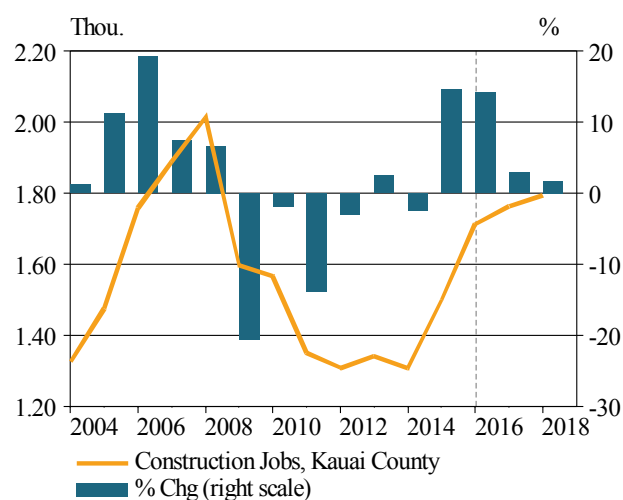
levels seen during the 2005-2007 boom. Payroll job growth will pick up a bit this year, slowing later in the decade as the construction cycle wanes and the county converges onto its trend growth path.

The Kauai construction industry turned the corner convincingly last year, and we expect strong expansion to continue this year. Last year construction hiring surged by double digits each quarter, peaking at more than 20% growth year-over-year in the fourth quarter. The industry remains smaller than during the mid-2000 bubble years, but further growth will bring total employment to 1,800 workers at its peak late in the decade.

In addition to the resort developments we discussed above, there are several residential and retail projects in the works. Early last year work got underway at PiliMai, a 191-unit luxury townhouse development in Poipu. Last summer, work was completed at Kolopua, a 44-unit workforce rental project in Princeville, and earlier this year construction began at Kanikoo Phase II, an affordable senior living complex in Lihue. On the commercial side, construction was completed earlier this year on the Garden Isle's first Kaiser Permanente clinic, and the Kilauea Lighthouse Village may break ground later this year.

Sales continue at Kukuiula, Alexander & Baldwin's large residential complex on the South Shore, which has entitlement for 750 units. The Hokua Place subdivision, which could eventually bring 769 units to the Kapaa area, is before the State Land Use Commission, where it faces challenges related to traffic. A draft environmental impact statement is currently open for public comment. DR Horton-Schuler Homes' planned Kohea Loa Project would bring nearly 300 units to the 50-acre Hanamaulu Triangle property.

The Kauai real estate market has seen considerable improvement, and both 2014 and 2015 were very strong sales years. Prices in inflation-adjusted terms have now returned to levels seen in the early 2000s, if below those at the mid-decade market peak. Sales are brisk at all price points and



THE KAUAI CONSTRUCTION INDUSTRY TURNED THE CORNER CONVINCINGLY LAST YEAR.

in nearly all areas of the island, except for the North Shore, where prices have spiked and inventory is scarce. Sales are led by domestic buyers, who are benefiting from low interest rates, the lift to disposable income from lower energy costs, and more secure employment conditions. Affordability remains the key challenge, and we will have more to say about this issue below.

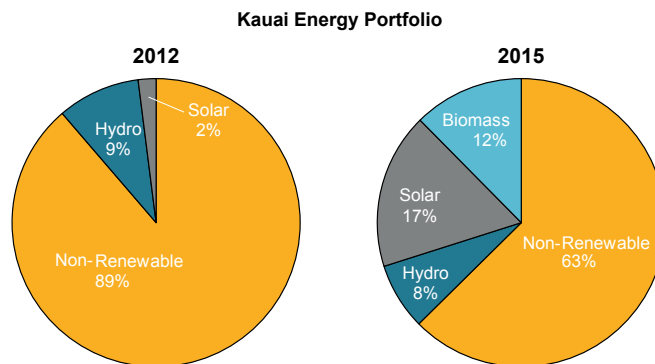
Outside of construction, moderate job growth will continue in most industries, tapering off over the next several years as the economy pushes up against full employment. Jobs in the accommodation and food services sector are now well above pre-recession levels thanks to strong visitor industry growth, and incremental tourism gains will generate job growth in the 1-2% range for the next several years. Buoyant construction will lift growth in the trade sector, which has languished recently. Jobs in our broad other services category will continue to see steady growth averaging about 1.5% over the next three years. The public sector, which was a significant drag on growth in 2015, will firm this year, but budgetary constraints at the federal, state, and local levels will hold job growth well below 1% for the next several years.

Health care on the Garden Isle is in transition. The troubled state health agency, Hawaii Health Systems Corporation, operates a pair of hospitals and multiple

clinics on Kauai. Late last year HHSC laid off a number of employees across the state, including thirty on Kauai. In response to rising deficits, the State transferred control of HHSC's facilities on Maui to Kaiser Hawaii, although at the moment there is no talk of privatizing Kauai facilities. Meanwhile private sector health care continues to expand, and we project that growth will continue to exceed that of the overall economy as the population ages and health spending rises.

There are several other sectors of the local economy that deserve particular attention. Kauai agriculture continues to see new opportunities, but also new controversy. The seed corn industry, the largest agriculture player on Kauai, has faced stiff opposition from environmental groups and some residents over concerns about risks from GMO crops and pesticide use. Recently, the industry has scaled back Kauai operations somewhat, although this apparently is driven less by domestic pushback and more by weak global conditions, including lower corn prices that have reduced seed demand, the development of an indigenous seed industry in China, and the strong dollar. Still, the industry employs about 300 people full time, 500 including temporary workers.

Pierre and Pam Omidyar's Ulupono initiative is working to establish a grass-fed dairy farm on 578 acres near Kauai's South Shore. Originally planned for 2,000 cows, the project has been scaled back to 699 cows, but still faces opposition from nearby resort interests and environmentalists. This has resulted in two pending lawsuits. An environmental impact study is underway. The Kilauea Community Agricultural Park is now under construction, which includes plans for new water infrastructure and a new community farm, and there are future plans for a food production and education center on the KCC campus. As elsewhere in the state, Kauai agriculture faces the challenge of high costs and a shortage of farmers who are equipped to maintain profitable businesses.



THE KIUC IS ON TRACK TO HAVE MORE THAN 50% OF ENERGY FROM RENEWABLES BY 2020.

A focal point for advanced technology is the Pacific Missile Range Facility on the Island's west side. Currently, the Range has a \$31 million electrical grid consolidation project underway, and they are exploring public-private partnerships for power generation. Activity ebbs and flows with test events, but all told about 1,000 military, civilian, and contract workers are employed at the facility.

The \$20 million Kauai Creative Technology Center is undergoing an environmental impact assessment and fund development. The 30,000 square foot facility is scheduled to open as early as the end of 2018. It will be a technology center providing professional studio space, media equipment, community facilities, and training for digital media users.

Kauai's energy sector is being transformed. Prompted in part by the State's renewable energy mandate, the Kauai Island Utility Cooperative is engineering a very rapid shift to renewable sources of power. This has been facilitated by technological changes that have sharply reduced costs. Kauai has been able to move faster than other counties, in part because of lower land costs and also financial advantages of the electrical utility's coop structure. Recently, the PUC approved a new solar farm with a path-breaking Tesla battery storage system and a hydroelectric plant. Combined with other recent investments, this puts KIUC on track to have more than 50% of energy from renewables by 2020.

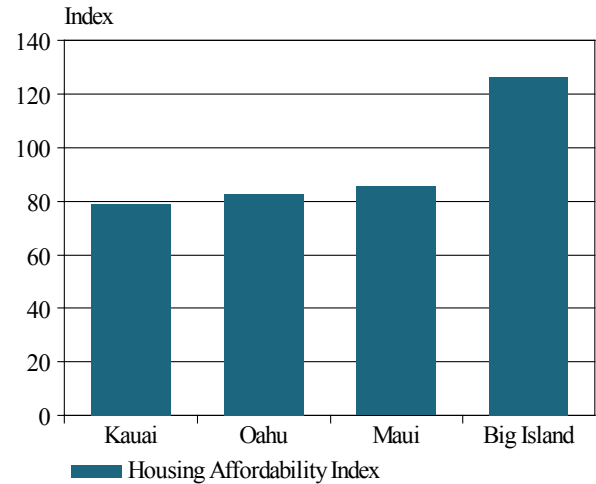
Overall job growth on Kauai Island will accelerate from 1.4% in 2015 to more than 2% this year, supported by surging construction and solid growth across a number of service sectors. The pace of hiring will drop back in 2017 and beyond, easing toward 1% late in the decade.

While official county income figures are not yet available for 2015, we estimate that the Garden Isle saw a healthy gain of 3.4% in real (inflation-adjusted) income. Almost a quarter of these gains came from the construction industry, where jobs tend to be relatively high paying. Real income got a boost from falling energy prices, which help to lift inflation-adjusted earnings. (Note that Neighbor Island income is deflated by the Honolulu CPI, the only measure of consumer prices available in the state.) Strong construction growth and mild inflation will support modest income gains over the next three years; we expect real income growth rates in the mid-2% range through 2018.

The Garden Isle continues to see among the State's highest rates of population growth. Over the last three years, annual population growth on Kauai has averaged 1.5%, compared with 1.3% on Maui and the Big Island and double the 0.7% rate seen on Oahu. The higher population growth has been driven largely by differences in in-migration rates; Kauai has the highest rate of in-migration of any county both from international and domestic sources.

## STRUGGLING THROUGH CHALLENGES

Kauai's economy is doing well, but there are three challenges that continually emerge in our conversations with business and government leaders: infrastructure, affordability, and workforce.



KAUAI IS AMONG THE LEAST AFFORDABLE HOUSING MARKETS IN HAWAII.

There are perennial concerns about the limits to the Kauai's infrastructure and the consequences for the Island's lifestyle. Above, we noted current concerns about visitor demands on parks and recreation and the kinds of policy responses that are being considered. There are also efforts to address traffic woes, including last year's trial of a shuttle service on the North Shore and the addition of bypass lanes at some key highway interchanges. New housing developments will likely need to invest in roadways to alleviate traffic pressure. Increasing demands on existing resources raise concerns about pushback against tourism, as well as resistance to needed housing.

And new housing will be needed going forward. Affordability remains a major challenge on Kauai, where the ratio of median single-family home price to household income makes the Island among the least affordable housing markets in Hawaii. Current rates of homebuilding are limited, and an important part of this is at the high end. Regulatory constraints are often cited by builders as an impediment, as well as high construction costs. On an island where residents worry about overbuilding, novel approaches may have a role to play. Currently lawmakers are considering



a bill that would permit landowners to construct an additional rental unit on their property, similar to an ordinance that has been adopted on Oahu.

The lack of affordable housing—particularly for the millennial generation—contributes to the third recurring challenge, the lack of an adequate workforce. Employers continually cite the dearth of sufficiently qualified employees as a leading problem and potentially a barrier to entry for national companies. With unemployment rates receding to normal levels, firms are reporting difficulty hiring workers with specialized skills, but the concerns extend to inadequate preparation of workers at nearly every skill level. These concerns are not lost on civic leaders. County and State agencies, PMRF, and business leaders are working to improve and realign training programs with skills that are in high demand. Workforce needs will become more acute as the existing Baby Boom generation ages into retirement.

These concerns are mounting at the same time that an array of planning initiatives is underway. The County is in the process of updating the Kauai General Plan, there is a new Tourism Strategic Plan, and the Kauai Economic Development Board is working to implement a Comprehensive Economic Development Strategy. Each process will certainly touch on these common concerns. Unfortunately, few of the Garden Isle's challenges have straightforward solutions. And working to alleviate one issue may exacerbate another. For example, Kauai residents generally want to maintain the island's rural, low-density character, which may conflict with the need to develop affordable housing. The benefits of authorizing new visitor plant development must be weighed against the strain that additional visitors place on the Island's roads, parks and sewers. Finding the right balance will be a significant challenge going forward.

MAJOR ECONOMIC INDICATOR SUMMARY  
KAUAI COUNTY FORECAST

	2013	2014	2015	2016	2017	2018
Non-farm Jobs (Thou)	29.1	29.6	30.0	30.6	31.0	31.3
% Change	3.1	1.6	1.4	2.1	1.2	1.2
Total Population (Thou)	69.7	70.7	71.7	72.4	73.1	73.8
% Change	1.7	1.4	1.5	0.9	1.0	0.9
Total Personal Income (Mil \$)	2,670.3	2,830.5	2,956.9	3,079.3	3,233.7	3,417.5
% Change	2.7	6.0	4.5	4.1	5.0	5.7
Inflation Rate, Honolulu MSA (%)	1.8	1.4	1.0	1.5	2.3	3.1
Real Personal Income (Mil 2015 \$)	2,736.0	2,858.8	2,956.9	3,035.3	3,114.8	3,193.0
% Change	0.9	4.5	3.4	2.7	2.6	2.5
Real Per Capita Income (Thou 2015 \$)	39.3	40.5	41.2	41.9	42.6	43.3
% Change	-0.8	3.1	1.9	1.7	1.6	1.6
TOURISM SECTOR DETAIL						
Total Visitors (Thou)	1,114.4	1,117.7	1,166.0	1,190.4	1,213.9	1,238.7
% Change	2.7	0.3	4.3	2.1	2.0	2.0
U.S. Visitors	909.5	911.8	943.7	964.5	982.3	1,002.1
% Change	2.0	0.2	3.5	2.2	1.8	2.0
Japanese Visitors	29.4	23.8	25.2	25.1	25.8	27.7
% Change	5.5	-19.0	5.8	-0.4	2.8	7.1
Other Visitors	175.4	182.1	197.1	200.8	205.8	208.9
% Change	6.4	3.8	8.3	1.9	2.5	1.5
Avg. Length of Stay (Days)	7.6	7.7	7.6	7.6	7.6	7.6
Visitor Days (Thou Days)	8,496.9	8,590.5	8,907.6	9,062.2	9,204.3	9,361.0
% Change	4.0	1.1	3.7	1.7	1.6	1.7
Occupancy Rate (%)	69.2	70.1	71.4	72.4	73.0	72.2
Total Room Stock (Thou)	10.1	10.1	10.1	10.1	10.1	10.5
% Change	0.2	0.0	0.1	0.1	0.1	3.5

Note: Source is UHERO. Historical figures for occupancy rate are from Hospitality Advisors LLC. Figures for 2015 Income are UHERO estimates. Figures for 2013 - 2015 room stock are UHERO estimates. Figures for 2016 - 2018 are forecasts.